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November 23, 2008

Ms. Anne Stausboll  
Interim Chief Investment Officer  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: Global Equity Policy – Internally Managed Global Equity Index Funds Policy Revision

Dear Anne,

You requested Wilshire's opinion with respect to Staff's proposed revisions to the Statement of Investment Policy for the Internally Managed Global Equity Index Funds Policy. Specifically, Staff is revising the benchmark for the Dynamic Completion Fund (DCF) such that the DCF would now "complete" the entire global equity portfolio, rather than just the external managers. Additionally, Staff is removing Argentina from the emerging markets component of the global equity benchmark, as was previously discussed with the Investment Committee.

### **Recommendation**

Wilshire recommends that the Policy Subcommittee approve the changes.

### **Background**

The Dynamic Completion Fund is intended to address residual style biases in the equity portfolio. By way of a simplified example, if due to attrition in the external manager portfolio, the portfolio contained a value bias (as measured by the benchmarks used), the DCF would intentionally overweight growth stocks via an index fund to offset the value bias. Practically, the DCF is intended to eliminate any residual size and style biases in the equity portfolio and create an overall program with size and style characteristics that more nearly match the exposures of the overall benchmark – a customized Wilshire 5000 Index for US equities and a customized FTSE All World, All Capitalization ex-US Index for non-US equities.

Currently, the DCF acts to complete only the external manager program. Since the DCF's inception, Staff has implemented a number of internal equity programs that may

contain some size or style biases and will likely continue to add to the platform of portfolios managed internally. This increase in internally-managed portfolios with some size or style biases results in the need to expand the reach of the DCF to re-balance the entire equity portfolio. Staff's proposed change to the DCF benchmark would include both externally-managed and internally-managed equity portfolios. For example, both the internal enhanced index portfolio and the internal fundamental index portfolio are both benchmarked to a customized Wilshire 2500 – a subset of the customized Wilshire 5000, which does not contain the smallest-cap stocks in the broader index. Put another way, each of these portfolios has a slight large cap bias compared to the broad US equity benchmark. In addition, the new internal synthetic enhanced portfolio will be managed using S&P 500 index futures, which, compared to the customized Wilshire 5000, creates a large cap bias. By including the internally managed programs among the assets covered by the DCF, the size biases will be combined (in this case they offset to some extent) and any residual bias will be offset by the DCF.

In addition, Staff has revised the emerging markets component to remove Argentina from the benchmark. Staff has previously discussed this change with the Investment Committee, citing the fact that private pensions are being nationalized in Argentina.

## **Conclusion**

Wilshire believes that the changes in the Policy are appropriate and will make the DCF a more effective tool in CalPERS current portfolio, where internally-managed portfolios are no longer solely broad-based index funds. In addition, including all internal and external equity portfolios under the coverage of the DCF will decrease tracking error of the overall Global Equity portfolio from unwanted style biases.

In addition, the elimination of Argentina from the internally managed index funds is consistent with what Staff has communicated to the Investment Committee and serves to protect CalPERS in an uncertain regulatory environment in that particular market.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read "Adam J. Smith". The signature is fluid and cursive, with the first name "Adam" and last name "Smith" clearly distinguishable.